No. 01-1880

In the Supreme Court of the United States

WALTER L. GROSS, JR., ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether, in valuing gifts of stock of an S corporation for gift tax purposes, the Tax Court erred in declining to reduce the anticipated future earning stream of the corporation by taxes which the corporation would not owe.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 3a-49a) is reported at 272 F.3d 333. The opinion of the Tax Court (Pet. App. 50a-79a) is unofficially reported at 78 T.C.M. (CCH) 201.

JURISDICTION

The judgment of the court of appeals was entered on November 19, 2001. A petition for rehearing was denied on March 21, 2002. Pet. App. 1a-2a. The petition for a writ of certiorari was filed on June 19, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On July 31, 1992, petitioners made gifts to their children of shares of stock in G&J Pepsi Cola Bottlers (G&J), a closely held, soft-drink bottling corporation. Pet. App. 55a- 56a. This case concerns the proper valuation of those shares for gift tax purposes.

a. The Internal Revenue Code imposes a tax on the transfer of property by gift. 26 U.S.C. 2501. The value of a gift of stock is the fair market value on the date the gift is made. 26 U.S.C. 2512; *United States* v. *Cartwright*, 411 U.S. 546, 551 (1973). Fair market value has been defined as the "price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of the relevant facts." 26 C.F.R. 25.2512-1. The determination of fair market value is a "question of fact" that depends upon the "circumstances in each case" and on "common sense, informed judgment and reasonableness." Rev. Rul. 59-60, 1959-1 C.B. 237, 238. The valuation dispute in the present case was not over the proper standard to be used in determining fair market value, for all agreed that the willing buyer/willing seller standard controls. Instead, the disagreement among the parties concerns how that governing standard applies in the particular context of this case. Pet. App. 21a.

b. Since 1982, G&J has elected to be taxed as an "S corporation." Pet. App. 5a. Subchapter S of the Internal Revenue Code (26 U.S.C. 1361-1379) allows certain small business corporations to elect "S corporation" status. 26 U.S.C. 1361, 1362. When a qualified corporation elects to be treated as an S corporation, it generally pays no corporate income tax. 26 U.S.C. 1363(a). Instead, the income of the S corporation flows through directly to its shareholders, who report and pay taxes on their pro rata shares of that income on their individual income tax returns.[1] 26 U.S.C. 1366(a)(1). S corporation status thereby provides a business with the "benefits of the corporate form—such as limited liability for shareholders—without the disadvantages of corporate taxation." *Durando* v. *United States*, 70 F.3d 548, 551 (9th Cir. 1995); see B. Bittker & J. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶ 5.01[5] (6th ed. 1994) (electing S corporation status allows "[a]voidance of the corporate tax altogether").

In 1982, the G&J shareholders signed an agreement that required G&J to retain S corporation status for at least 10 years. The shareholders also agreed to prohibit any transfers that would jeopardize the S corporation status of the corporation. Pet. App. 5a-6a. When the gifts involved in this case were made in July 1992, G&J thus remained an S corporation. Moreover, no plans existed to alter or change that status on that date. *Id.* at 6a.

G&J was a well-managed and successful corporation. It was the third-largest independent Pepsi Cola bottler and enjoyed steadily increasing sales during the five-year period preceding the valuation date. The income of G&J, and its distributions to its shareholders, also steadily increased from 1988 through 1992. During each of these years, G&J distributed nearly all of its income to its shareholders. Pet. App. 6a-7a.

Petitioners filed gift tax returns which valued their 1992 gifts of stock at $5,680 per share. That valuation

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[1] By contrast, an ordinary corporation pays taxes on its income and its shareholders also pay taxes on any income distributed as dividends by the corporation.

was based on a report prepared by their appraiser, David McCoy. On audit, the Commissioner of Internal Revenue initially valued the stock at $11,738 per share. On subsequent consideration of additional data, however, the Commissioner determined that the proper value for gift tax purposes was $10,910 per share. Pet. App. 7a-8a.

2. Petitioners challenged the Commissioner's determination in the Tax Court. The case proceeded to a three-day trial, with both sides relying on the reports and testimony of expert witnesses. Pet. App. 8a.

On review of all the evidence, the Tax Court found that the value of a share of stock in G&J on the date of the gifts was $10,910, as advocated by the Commissioner. The Tax Court noted, as a preliminary matter, that valuation is an issue of fact on which petitioners must bear the ultimate burden of proof. Pet. App. 57a. After considering the testimony and reviewing the experts' reports, the court concluded that the Commissioner's expert was more credible and persuasive on each point of disagreement. *Id.* at 71a-77a.

The expert witnesses for both parties applied an income-stream approach in determining the value of G&J stock. Under that approach, a company's fair market value is determined by calculating the present value of its projected future income stream. Pet. App. 58a-59a, 62a. The experts also agreed that the value of G&J shares should be discounted to reflect the fact that, as shares of a closely held S corporation, they were not readily marketable. *Id.* at 60a-63a. The experts disagreed, however, as to the appropriate amount of that discount. *Ibid.* The Tax Court found the Commissioner's expert to be more credible than petitioners' experts and concluded that the appropriate discount for lack of marketability was 25 percent, rather than 35 percent as petitioners had urged. *Id.* at 77a.

The additional major area of disagreement between the parties' experts related to whether the projected future income of G&J should be reduced by hypothetical corporate income taxes even though G&J, as an S corporation, does not pay corporate income taxes. See page 2-3, *supra*. Such a reduction is referred to as "tax-affecting" the income stream. Pet. App. 9a-10a. The Commissioner's expert took the position that there was no basis for reducing the amount of the cash flow by a fictitious corporate income tax because (i) G&J was an S corporation and, as of 1992, was likely to remain an S corporation and (ii) G&J distributed almost all of its income to its shareholders on an annual basis. *Id.* at 62a. Petitioners' valuation expert, David McCoy, testified, by contrast, that the projected cash flow of the S corporation should be reduced by a fictitious 40 percent corporate income tax because such a reduction was an accepted practice among valuation professionals and was necessary to offset certain potential disadvantages of an S corporation. *Id.* at 59a-60a, 71a-72a.

The assertions made by petitioners' expert, however, did not stand up on cross-examination. Under questioning, he conceded that he was uncertain whether tax-affecting was generally accepted and acknowledged that there was disagreement on that issue among valuation experts. Pet. App. 44a-45a. He also admitted that the treatise that his report relied on did *not* say that tax-affecting was the "accepted method" and instead concluded that "the valuation profession is struggling with how non-taxable entities should be treated for valuation purposes." Tr. 267-268; C.A. App. 269-270. He also conceded that there was a "growing controversy" about whether to use tax-affecting, that "different practitioners were using different methods," and that, if he had to value G&J again, he might not use the tax-affecting methodology. Tr. 258, 274; C.A. App. 260, 276. A rebuttal witness thereafter offered by petitioners similarly conceded that there was no uniform view regarding tax-affecting in the appraisal community in the late 1980's. Tr. 496.

After considering this testimony, the Tax Court found, on the facts of this case, that petitioners' experts had not established that it was appropriate to tax-affect G&J's projected future income when valuing G&J through a discounted cash flow approach. Pet. App. 75a-76a. The court noted that the "principal benefit" of S corporation status is the avoidance of corporate taxes, and it found "no reason why th[ose tax] savings ought to be ignored" in valuing the corporation. *Ibid.* The court rejected petitioners' claim that tax-affecting was necessary to offset potential disadvantages of S corporation status because, as the court emphasized, the facts of this case showed that it was not reasonable to assume that G&J's shareholders would suffer any of those disadvantages. *Id.* at 71a-72a. For instance, the court noted that G&J had a strong growth record and a history of distributing nearly all of its income to its shareholders. *Id.* at 72a. The Tax Court therefore found that it was not reasonable to assume that G&J would not make sufficient distributions to cover its shareholders' tax obligations. *Ibid.* Similarly, the Tax Court did not think the possibility that G&J might lose its S corporation status warranted tax-affecting with an undiscounted corporate tax rate since the record in this case presented no "facts or circumstances sufficient to establish the likelihood that the election would be lost." *Ibid.* On this record, the court agreed with the Commissioner's expert that it was appropriate to apply a zero-percent corporate tax rate when calculating G&J's value. *Id.* at 73a.

In addition to crediting the Commissioner's expert over petitioners' experts, the Tax Court also rejected petitioners' contention that two statements in internal IRS manuals (set forth at Pet. App. 70a) reveal that the Commissioner had advocated tax-affecting and must be held to it. *Id.* at 70a-71a. Neither of the manuals adopts tax-affecting as a standard practice when valuing the projected income of an S corporation. One manual simply states that, in comparing S corporations to publicly traded firms, adjustments for income taxes "will avoid distortions when applying industry ratios such as price to Earnings." *Id.* at 70a. The other manual similarly refers to no particular valuation method or purpose. *Ibid.* The Tax Court found that neither of the vague references in these two manuals purports to require tax-affecting in valuation determinations.[2] *Ibid.* Moreover, each of the manuals cited by petitioners expressly states that these internal documents are not to be relied on as technical positions of the IRS. J.A. 862, 873. The Tax Court concluded that the statements contained in the agency's internal manuals thus lack the force and effect of a formal regulation or ruling. Pet. App. 71a. The court also noted that petitioners had, in fact, made no claim to the contrary. *Ibid.*

After examining all the facts in the record, the court determined not to reduce G&J's cash flow for taxes that G&J did not pay and was not expected to pay in the

[2] The court also pointed out that, even if the manuals did support the use of tax-affecting, petitioners had failed to prove that they relied on either of the documents in any way. Pet. App. 71a.

foreseeable future. The court concluded that, although tax-affecting might be appropriate on a different record, it was unreasonable to tax-affect in the circumstances of this case. Pet. App. 72a. Based on its factual determinations, the Tax Court concluded that the fair market value of a share of G&J stock on July 31, 1992 was $10,910. *Id.* at 7a-79a.

3. A divided panel of the court of appeals affirmed. Pet. App. 3a-49a. All members of the panel agreed that the determination of the fair market value of the stock was a question of fact to be reviewed under the "clearly erroneous" standard. *Id.* at 21a. The panel also agreed that the Tax Court's application of a 25 percent, rather than a 35 percent, discount for lack of marketability was not clearly erroneous. *Id.* at 38a. The only difference of opinion among the panel members was as to tax-affecting, with the majority and Judge Clay, in dissent, "read[ing] the record differently" on this issue. *Id.* at 45a.

The majority pointed out that this case was a "battle of the experts" and concluded that the Tax Court did not clearly err in finding the Commissioner's expert to be more credible. Pet. App. 40a. The majority upheld the finding of the Tax Court that the valuation method applied by the Commissioner's expert "was the better reasoned one under the facts and circumstances of the case," particularly given that G&J, as an S corporation, in fact did not pay corporate taxes and that there was no reason to believe that it would lose its S corporation status. *Id.* at 46a-48a. The majority also agreed with the Tax Court that the internal IRS manuals did not purport to require tax-affecting for all S corporation valuations and could not reasonably be relied upon by petitioners. *Id.* at 46a.

The majority also rejected petitioners' effort to rely on the fact that the IRS had accepted, without contest, prior estate and gift tax returns of petitioners and other G&J shareholders using values that were based on appraisals that used tax-affecting. Pet. App. 48a. The court noted that the fact that tax-affecting had not been challenged in some prior returns does not preclude the Commissioner from properly valuing the stock in this case. *Id.* at 48a-49a.

Judge Clay dissented. He concluded that the Tax Court was clearly erroneous in rejecting the factual contention of petitioners that "hypothetical parties to a sale of G&J stock" would have considered tax-affecting on the date that the gifts were made. Pet. App. 34a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Petitioners' challenge to the Tax Court's determination of the value of petitioners' stock for gift tax purposes presents a factbound question of limited effect that does not warrant review by this Court.

1. Petitioners argue that, in valuing the G&J stock for gift tax purposes, the Tax Court should have accepted their expert's valuation methodology instead of that of the Commissioner's expert. As the court below noted, however, "[v]aluation is a fact specific task exercise." Pet. App. 49a. See *Suitum* v. *Tahoe Regional Planning Agency*, 520 U.S. 725, 741 (1997) (valuation is "simply an issue of fact"); *SEC* v. *Central-Illinois Securities Corp.*, 338 U.S. 96, 146-147 & n.44 (1949) (stock valuation "is predominately a question of fact"); *Estate of Godley* v. *Commissioner*, 286 F.3d 210, 214 (4th Cir. 2002) ("valuation determinations are

clearly questions of fact"); *Sisto Fin. Corp.* v. *Commissioner*, 149 F.2d 268, 269 (2d Cir. 1945) (L. Hand, J.) (the scope of appellate review is "particularly narrow" when the factual issue "is one of value"). Moreover, "[t]he choice of the appropriate valuation methodology for a particular stock is, in itself, a question of fact." *Estate of Newhouse* v. *Commissioner*, 94 T.C. 193, 245 (1990). See 5 B. Bittker & L. Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 135.5.2, at 135-90 (2d ed. 1993) ("the trial court almost always has the final word [on valuation issues] because the issues are largely if not wholly factual").

There is ample evidence to support the findings of the Tax Court, and the court of appeals correctly rejected petitioners' challenge to the valuation determination made by the Tax Court. Further review of those findings is unwarranted, for "this Court has frequently noted its reluctance to disturb findings of fact concurred in by two lower courts." *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317-318 n.5 (1985) (quoting *Rogers* v. *Lodge*, 458 U.S. 613, 623 (1982)). Although petitioners take issue with these findings, this Court does not "undertake to review concurrent findings of fact by two courts below in the absence of a very obvious and exceptional showing of error." *Graver Tank & Mfg. Co.* v. *Linde Air Prods. Co.*, 336 U.S. 271, 275 (1949). The Court has long made clear that it "do[es] not grant a certiorari to review evidence and discuss specific facts." *United States* v. *Johnston*, 268 U.S. 220, 227 (1925). See Sup. Ct. R. 10.[3]

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[3] While the focus of the petition is on the tax-affecting issue, petitioners also challenged below the Tax Court's choice of a 25 percent, rather than a 35 percent, marketability discount. That factual determination, which was unanimously upheld by the court

2. Not surprisingly, in view of the factbound nature of this case, the decision of the court of appeals does not conflict with any decision of this Court or any other court of appeals. In an attempt to avoid the factual nature of the dispute, petitioners and amici mischaracterize the case as one involving a retroactive change in the tax law, and they then assert (Pet. 9-14; Amici Br. 10) that the decision below is inconsistent with decisions that restrict an agency's ability to engage in retroactive rulemaking.

The cases cited by petitioners and amici are plainly inapposite, however, because this case does not present a retroactive application of a "new rule" (Pet. 8). Instead, this case involves simply a "battle of the experts" (Pet. App. 40a) over how to apply an old rule—the willing buyer/willing seller standard—to a particular set of facts.[4] The Tax Court found the Commissioner's

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of appeals (Pet. App. 38a), does not warrant further review. The proper amount of such a discount is a purely factual issue. *Estate of Berg* v. *Commissioner*, 976 F.2d 1163, 1165 (8th Cir. 1992). Moreover, the Tax Court's allowance of a 25 percent marketability discount was more generous to the taxpayers than that afforded in other cases. See, *e.g.*, *Estate of Ford* v. *Commissioner*, 53 F.3d 924, 928 (8th Cir. 1995) (upholding 10% marketability discount); *Citizens Bank & Trust Co.* v. *Commissioner*, 839 F.2d 1249, 1255 (7th Cir. 1988) (20% marketability discount).

[4] Contrary to petitioners' suggestion (Pet. 14-17), the decision in this case does not violate 26 U.S.C. 7805(b), which limits the retroactive application of Treasury regulations. The dispute in this case concerns an appraisal methodology that was the subject of divergent expert testimony, not a regulation. Moreover, even if a regulation were at issue here (and it is not), Section 7805(b) only affects regulations relating to statutory provisions enacted on or after July 30, 1996. *Esden* v. *Bank of Boston*, 229 F.3d 154, 171-172 n.21 (2d Cir. 2000), cert. dismissed, 531 U.S. 1061 (2001). The

expert more credible and accepted his valuation methods, and the court of appeals affirmed that finding. Petitioners cannot properly challenge that concurrent factual finding simply by mischaracterizing it as an improper retroactive rule.

Petitioners err in claiming that, prior to this case, the Commissioner had established a legal "rule" that the tax-affecting methodology was a necessary component of S corporation valuations. In fact, as both courts below correctly concluded (Pet. App. 46a, 70a), the IRS has never issued a regulation or ruling (or any other document for the guidance of the public) that requires that the projected earnings of an S corporation be reduced by hypothetical corporate income taxes in valuing the corporation.[5] Indeed, petitioners' lead expert conceded that in 1992 there was "no rule" that S corporations must be tax-affected for valuation purposes and that the applicability of tax-affecting depended on the facts of any given case. Tr. 273; C.A. App. 275. He further acknowledged that tax-affecting was only one of several alternative methods used to value S corporations. Tr. 258, 274; C.A. App. 260, 276.

Moreover, neither the IRS nor either of the courts below has determined that tax-affecting is never appropriate when valuing S corporations. Instead, both courts below explicitly stated that the decision not to tax-affect G&J was driven by the facts of this case and not by any "new rule" espoused by the Commissioner. The court of appeals emphasized that the Tax Court

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gift tax imposed under 26 U.S.C. 2512 was in effect long prior to that date.

[5] And, as is discussed in detail at pages 15-17, *infra*, the internal agency manuals cited by petitioners specify that they may "not be relied on as binding authority." Pet. App. 46a.

determined only "that tax affecting was not appropriate in this case" (Pet. App. 49a), and the Tax Court concluded that it was not reasonable to tax-affect an S corporation's projected earnings "without facts or circumstances sufficient to establish the likelihood that the [S corporation] election would be lost" (*id.* at 72a). Indeed, the Tax Court emphasized that it *would* consider the appropriateness of tax-affecting an S corporation in a case where the facts were different. *Ibid.*

The parties in this case did not disagree as to the proper valuation rule. Instead, they disagreed as to how the facts of this case apply under the accepted rule. As the court of appeals noted in affirming the findings below, the application of the willing-buyer/willing-seller valuation rule to the facts of this case presents questions of fact, not of law. Pet. App. 21a. Petitioners simply failed to persuade the Tax Court that its appraisal method was sound as applied to the specific factual situation of G&J. The fact that the Tax Court determined that tax-affecting is inappropriate in this case, even though it may be appropriate in other cases, does not demonstrate the retroactive application of a "new rule." It is instead a manifestation of the established principle that valuation determinations are fact specific and ultimately depend on the individual circumstances of each case. See pages 9-10, *supra*.

3. The court of appeals correctly held that the Tax Court did not clearly err in its valuation of the G&J stock. It has long been the rule that elements of "common sense, informed judgment and reasonableness" must enter into the valuation process. Rev. Rul. 59-60, *supra*. It was in accord with "common sense" and "informed judgment" for the Tax Court not to reduce G&J's cash flow for taxes that G&J did not pay and was not expected to pay in the foreseeable future.

The evidence in this case plainly supports the trial court's determination that G&J would not be paying corporate taxes for the foreseeable future. As of the date of the gift, July 31, 1992, G&J had been an S corporation (and thus did not pay federal corporate income tax) for ten years. Moreover, G&J had no plans to change its S corporation status in the foreseeable future. Pet. App. 6a. The G&J shareholders agreement specifically proscribed share transfers that could cause termination of G&J's S corporation status. *Id.* at 5a-6a. And, G&J had flourished as an S corporation, with a strong growth record. *Id.* at 54a, 72a. Given these facts, the Tax Court correctly found that there was no reason to assume that G&J would lose its S corporation status and become subject to corporate income taxes in the foreseeable future. *Id.* at 71a-72a.

Indeed, petitioners do not attempt to justify the use of a tax-affecting valuation method under the particular facts and circumstances of this case. Instead, they claim that the courts erred in refusing to tax-affect G&J's projected income because tax-affecting was the "generally accepted valuation practice" and was the IRS's "own practice as evidenced by its own documents and the only case law touching on these issues." Pet. 5. Petitioners also further assert that they "relied" (Pet. 7) on the prior acceptance of tax-affecting by the IRS. These arguments are in error.

a. Petitioners' characterization of tax-affecting as the generally accepted valuation practice is not supported by the record in this case. As the courts below correctly noted, the experts disagreed over whether tax-affecting was a generally accepted practice in 1992. Moreover, petitioners' lead expert, Mr. McCoy, conceded on cross-examination that "he was not certain whether tax affecting was generally accepted, acknowledged some disagreement on this point, and was equivocal on whether he would continue to tax affect."[6] Pet. App. 44a-45a. This testimony plainly contradicted petitioners' assertion that the decision of the Commissioner's expert not to tax-affect G&J represented an "entirely novel methodology" (Pet. 6).

The record demonstrates that, rather than being "generally accepted," tax-affecting was a disputed practice in 1992. And, even if tax-affecting was a standard practice in 1992, petitioners' experts acknowledged that appraisers were also using other methods at that time. Pet. App. 44a-45a. Petitioners thus failed to establish any basis for the assertion that the Commissioner was required by common practice to use the tax-affecting methodology. Moreover, the courts below did not err in finding that that method was not appropriate on the facts of this particular case.

b. Tax-affecting also had not been "endorsed" (Pet. 7) as the correct valuation method by the IRS. The IRS has never published a regulation, ruling, or any other document providing public guidance on when or whether projected earnings of an S corporation should be tax-affected in valuing the corporation.

Petitioners err in citing (Pet. 7) two internal agency manuals in support of their claim that tax-affecting was the expressly endorsed position of the IRS. As both the Tax Court and the court of appeals concluded, these internal manuals expressly state that they are not to be

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[6] Petitioners' attempt to focus the dispute in this case on the question of the prevailing valuation standard in 1992 is, in any event, misdirected. As the court below explained, "the purpose of valuation is to determine what a willing buyer would pay, and what a willing seller would accept, for the stock on the date of the valuation; it is not to determine what methodology the willing buyer would apply." Pet. App. 49a.

relied upon as binding authority; they thus cannot establish any binding administrative position with regard to tax-affecting. Pet. App. 45a-46a, 70a-71a. Moreover, these internal manuals are vague as to the precise type of "adjust[ment]" they contemplate and they cannot be read as either "requiring tax affecting [or] laying the basis for a claim of detrimental reliance." *Id.* at 70a. See *id.* at 46a (the manuals do not "advocate tax affecting for all S Corporation valuation").[7]

Morever, it is well established that internal IRS manuals may not be relied on by taxpayers because such manuals are intended only for the internal administration of the agency and do not confer any rights on a taxpayer. *United States* v. *Horne*, 714 F.2d 206, 207 (1st Cir. 1983) (whether tax assessment complied with rules in Internal Revenue Manual had no bearing on its validity and taxpayer "could not contend that he reasonably relied on [those rules] to his detriment"). A taxpayer cannot rely on internal IRS manuals which "do not have the force and effect of law," for "their purpose is to govern the internal affairs of the [IRS]." *Ibid.* (internal quotation marks and citation omitted). The manuals cited by petitioners in this case make this point expressly, for they state that they "are not to be relied upon as binding authority." Pet. App. 46a. The courts below thus correctly held that petitioners could not

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[7] The decision in *Estate of Bright* v. *United States*, 658 F.2d 999 (5th Cir. 1981), cited by petitioners (Pet. 13-14), is thus inapposite because the court in that case was concerned with taxpayer reliance on "established tax principles." The two vague and isolated references in internal IRS training manuals to tax-affecting do not rise to the level of an "established tax principle" and do not support petitioners' assertion that a "longstanding administrative practice" (Pet. 15) supports tax-affecting under the specific facts of this case.

justifiably rely on the manuals that they cite in this case. *Id.* at 46a, 71a.

c. Contrary to petitioners' assertion, the valuation made by the Tax Court in this case is not contrary to the "only case law" (Pet. 5) regarding tax-affecting. Indeed, prior to the decision in this case, only one other case had considered the merits of tax-affecting and, in that case as here, the court *rejected* the use of tax-affecting. The court held in that case that "ignoring taxes altogether is the only way that the discounted cash flow analysis can reflect accurately the value of [the S corporation's] cash flows to its investors." *In re Radiology Assocs., Inc.*, 611 A.2d 485, 495 (Del. Ch. 1991).

The two Tax Court memorandum decisions cited by petitioners (Pet. 5) and by the dissent (Pet. App. 29a)[8] do not conflict with the decision in this case. The merits of tax-affecting were not at issue and were not discussed in those decisions. Indeed, only the most vigilant reading of those cases reveals that a corporate income tax was incorporated in the valuations. The fact that tax-affecting may have underlain the valuations submitted by the experts in those cases does not establish a rule that tax-affecting must be applied in every (or even in any) other Tax Court case.

d. Petitioners also err in seeking to rely on the fact that the Commissioner did not challenge prior gift and estate tax returns of related parties that may have been based on tax-affected valuations of G&J's stock. A taxpayer cannot avoid payment of a tax rightfully due by arguing that he or some other taxpayer previously escaped their obligations. See, *e.g.*, *Joseph Gann, Inc.*

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[8] *Maris* v. *Commissioner*, 41 T.C.M. (CCH) 127 (1980); *Hall* v. *Commissioner*, 34 T.C.M. (CCH) 648 (1975).

v. *Commissioner*, 701 F.2d 3, 5 (1st Cir.), cert. denied, 464 U.S. 821 (1983); *Mid-Continent Supply Co.* v. *Commissioner*, 571 F.2d 1371, 1376 (5th Cir. 1978); *Sirbo Holdings, Inc.* v. *Commissioner*, 509 F.2d 1220, 1222 (2d Cir. 1975). Moreover, as this Court stated in *Dickman* v. *Commissioner*, 465 U.S. 330, 343 (1984), even if the Commissioner's "present position represents a departure from prior administrative practice * * * it is well established that the Commissioner may change an earlier interpretation of the law, even if such a change is made retroactive in effect" and "even though a taxpayer may have relied to his detriment upon the Commissioner's prior position." See also *Carpenter* v. *United States*, 7 Cl. Ct. 732, 740 (1985), aff'd, 790 F.2d 91 (Fed. Cir. 1986).

4. Petitioners (Pet. 19-23) and amici (Amici Br. 11-12) err in their description of the importance of this case. The court of appeals did not craft a new rule to be applied in all valuation cases. Instead, the court specifically held that, under the particular facts and circumstances of this case, the use of a zero tax rate in valuing an S corporation that had no tax obligation was not clearly erroneous. Pet. App. 49a. See also *id.* at 72a. Expert commentators have recognized that the holding of the Tax Court and the court of appeals is based on the specific facts of this case. See, *e.g.*, L. Avener & M.B. DeSimone, *S Corp Valuations: No Definitive Guidance Despite* W.L. Gross, Taxes 3-4 (Feb. 2000) (stating that "[t]ax affecting S corps has always been controversial" and that the court in *Gross* ruled only that "tax-affecting was inappropriate under the facts presented" and "did not attempt to dictate valuation procedure"); E. Giardina, *The* Gross *Decision – Where Do We Go from Here*, 5 Valuation Strategies 4, 7 (May/June 2002) ("The *Gross* decision was about

evidence, or lack of it."); C. Glass & S. Mueller, Analysis of the *Gross* Case, Prepared for The American Society of Appraisers 19th Annual Advanced Business Valuation Conference 6 (Nov. 2000) (the "[s]pecific facts of [*Gross*] support ruling" by the Tax Court) (cited by petitioners (Pet. 21)). Because the decision was grounded in the particular facts of this case and involved no new legal standard, petitioners' assertions that the "wrong result in this case will have an effect on many ESOP valuations" (Pet. 22) and that the decision will have "sweeping consequences" (Pet. 19) are unfounded.[9]

Moreover, as petitioners' valuation expert acknowledged, views toward tax-affecting have been evolving in the appraisal community. Tr. 257-258, 274; C.A. App. 259-260, 276. See, *e.g.*, M. Luttrell & J. Freeman, *Taxes and the Undervaluation of 'S' Corporations*, 15 Amer. J. of Fam. Law 301 (2001) (concluding that tax-affecting is not an appropriate methodology for valuing S corporations). Neither the Commissioner nor the Tax Court can be said to have "changed" valuation "rules"

[9] The proposed regulations of the Department of Labor for valuing ESOPs—which are cited by petitioners (Pet. 22)—are modeled on the guidelines of Rev. Rul. 59-60, which expressly states that valuation "being a question of fact, will depend upon the circumstances in each case." In the ERISA area, as in the tax area, courts have recognized that valuation of the stock of a closely held corporation is a factbound, case-by-case undertaking. See *Donovan* v. *Cunningham*, 716 F.2d 1455, 1473 (5th Cir. 1983), cert. denied, 467 U.S. 1251 (1984) (holding that ERISA fiduciaries who failed to follow IRS precedent did not violate ERISA because "[a]ppraisal of closely-held stock is a very inexact science" and given the "variety of potential fact patterns," fiduciaries were not required to "follow a specific valuation approach as a matter of law").

simply by following expert judgment on this factual issue.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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